

REPORT OF EXAMINATION
OF THE
CYPRESS INSURANCE COMPANY

AS OF
DECEMBER 31, 2004

Participating State
and Zone:

California

Filed May 25, 2006

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San Francisco, California
February 10, 2006

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Gary L. Smith
Secretary, Zone IV-Western
Director of Insurance
Department of Insurance, State of Idaho
Boise, Idaho

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Director and Commissioner:

In accordance with your instructions, an examination has been conducted of the

CYPRESS INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 9290 West Dodge Road, Suite 300, Omaha, Nebraska 68114. The Company's statutory home office and main administrative office is located at 395 Oyster Point Blvd., Suite 222, South San Francisco, California 94080.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2001. This examination covers the period from January 1, 2002 through December 31, 2004. The examination was conducted in accordance with the National Association of Insurance

Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2004, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

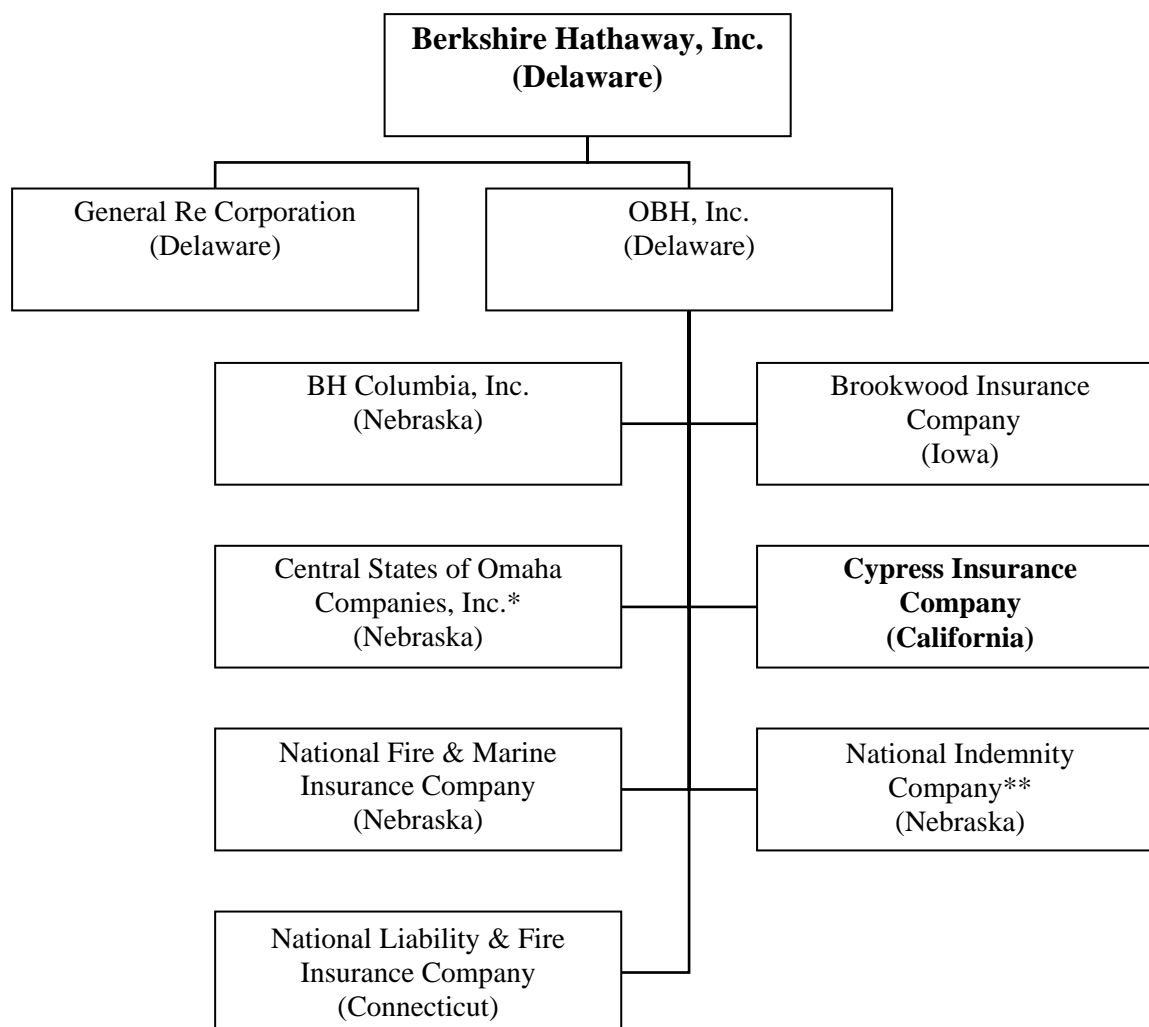
COMPANY HISTORY

The Company was incorporated under the laws of the State of California on October 17, 1962, and commenced business on March 8, 1963. In 1996, the Company changed its common stock par value from \$12.50 to \$50 per share, resulting in an increase in capital paid-up of \$3.9 million. At December 31, 2004, capital paid-up of \$5,200,000 consists of 104,000 authorized and outstanding shares of common stock with a \$50 par value.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Berkshire Hathaway Inc., a Delaware company, is the ultimate controlling entity. Financial control (31%) of the holding company is held by Warren E. Buffet. The holding company acquired its interest in the Company, via a dividend from its wholly-owned subsidiary, National Fire and Marine Insurance Company. The Company is one of thirty-four property and casualty insurance carriers under the financial control of Berkshire Hathaway, Inc. Since 1998, the Company has been wholly owned by OBH, Inc., a wholly-owned subsidiary of the ultimate holding company.

The following abridged organizational chart depicts the Company's relationship within the holding company system (all ownership is 100% unless otherwise indicated):



*OBH, Inc. owns 86.9%.

**National Indemnity Company is the largest affiliated insurer.

Management of the Company is vested in a three-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2004 follows:

Directors

Name and Residence

Rodney D. Eldred
Alpharetta, Georgia

Principal Business Affiliation

President
Homestate Companies

Directors (continued)

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Michael A. Goldberg Santa Barbara, California	President and Director Berkshire Hathaway Credit Corp.
Joseph G. Casaccio Stamford, Connecticut	Vice President and Legal Counsel National Liability & Fire Insurance Co.

Principal Officers

<u>Name</u>	<u>Title</u>
Rodney D. Eldred	President
Jackie L. Perry	Secretary and Assistant Treasurer

Intercompany Agreements

On November 23, 1994, the Company entered into a formal written Intercompany Service Agreement, with other affiliated insurance subsidiaries, which provides for the following services: accounting, tax and auditing; underwriting; claims; investments; and financial support services. Each member may provide to other members any of the noted services. The costs of these shared services are allocated on an actual cost basis. The terms of the Intercompany Services Agreement also provide for the filing of a consolidated federal income tax return. The consolidated federal tax liability is allocated among the subsidiaries in the ratio that each subsidiary's separate tax return liability bears to the total consolidated federal tax liability.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2004, the Company was licensed to transact multiple lines of property and casualty insurance in Arkansas, California, Georgia, Idaho, Mississippi, New Mexico, South Carolina, and Tennessee. The Company is also authorized to write on a surplus line basis in the State of Nebraska.

In 2004, direct premiums written were \$40,923,517 of which California's direct premiums written amounted to 49% of the total. The principal line of business written is workers' compensation, which amounted to 100% of the Company's net premiums written.

The Company's business is written through approximately 360 brokerage firms and independent agencies. The Company maintains branch offices in San Francisco and Pasadena, California.

REINSURANCE

Assumed

The Company assumes reinsurance from some of its affiliates. The principal treaties, retentions and assumed limits in effect at December 31, 2004 are set forth as follows:

<u>Type of Contract</u>	<u>Ceding Company</u>	<u>Ceding Company's Retention</u>	<u>Company's Maximum Limits</u>
<i>Workers' Compensation</i>			
Quota Share	National Fire & Marine Insurance Company	None	100% of all gross liabilities
Quota Share	National Indemnity Company	None	100% of all gross liabilities
Quota Share	National Liability & Fire Insurance Company	None	100% of all gross liabilities
Quota Share	Cornhusker Casualty Company	None	100% of all gross liabilities
Quota Share	Oak River Insurance Company	None	100% of all gross liabilities
Quota Share	Redwood Fire & Casualty Insurance Company	None	100% of all gross liabilities
Quota Share	Brookwood Insurance Company	None	100% of all gross liabilities
<i>Surety</i>			
Quota Share	National Indemnity Company	None	100% of all gross liabilities
<i>Casualty</i>			
Quota Share (runoff)	Dean's & Homer MGA	None	10% of all gross liabilities
Excess of Loss	Redwood Fire & Casualty Insurance	\$100,000	\$500,000 each and every loss occurrence

<u>Type of Contract</u>	<u>Ceding Company</u> Company	<u>Ceding Company's</u> <u>Retention</u>	<u>Company's Maximum</u> <u>Limits</u>
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Ceded

The principal treaties, retentions and ceded limits in effect or in runoff at December 31, 2004 are set forth as follows:

<u>Type of Contract</u>	<u>Reinsurer</u>	<u>Company's Retention</u>	<u>Reinsurer's Maximum</u> <u>Limit</u>
<i>Workers' Compensation</i>			
Excess of Loss (runoff)	General Reinsurance Company	\$1,000,000 each loss occurrence	\$4,000,000 each loss occurrence
Excess of Loss (runoff)	General Reinsurance Company	\$200,000 each loss occurrence	\$4,800,000 each loss occurrence
Excess of Loss (runoff)	Redwood Fire & Casualty Insurance Company	\$500,000 each loss occurrence	\$500,000 each loss occurrence
Excess of Loss	National Indemnity Company	\$5,000,000	\$5,000,000
Excess of Loss	American Reinsurance Company	\$1,000,000	\$4,000,000
Excess of Loss (runoff)	North American Reinsurance	\$200,000	\$4,800,000
Quota Share (runoff)	Wesco-Financial Insurance Company	None	50% Quota Share for policy years 1990 & 1991
Quota Share (runoff)	General Reinsurance Company	None	75% Facultative Quota Share
Quota Share	Cornhusker Casualty	None	100% Quota Share
Quota Share	Oak River Insurance Company	None	100% Quota Share

ACCOUNTS AND RECORDS

Information Systems Review

The Company uses a third party vendor, Remote Data Solutions (RDS), to provide data processing services. A review was performed of RDS and deficiencies were noted in vendor

management and control, disaster recovery and business continuity, and physical access to the data center. It is recommended that the Company work with RDS to resolve these issues.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2004

Underwriting and Investment Exhibit for the Year Ended December 31, 2004

Reconciliation of Surplus as Regards Policyholders from December 31, 2001 through December 31, 2004

Statement of Financial Condition
as of December 31, 2004

	<u>Ledger and Non-ledger Assets</u>	<u>Non- Admitted Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
<u>Assets</u>				
Bonds	\$ 33,451,859	\$	\$ 33,451,859	
Stocks:				
Common stocks	196,624,618		196,624,618	(1)
Cash and short-term investments	114,937,370		114,937,370	
Receivable for securities	1,750		1,750	
Investment income due and accrued	356,347		356,347	
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	1,328,206	138,425	1,189,781	
Reinsurance:				
Amounts recoverable from reinsurers	584,698		584,698	
Furniture and equipment	148,936	148,936		
Other assets nonadmitted	710,743	710,743		
Aggregate write-ins for other than invested assets	<u>439,051</u>		<u>439,051</u>	
Total assets	<u>\$348,583,578</u>	<u>\$ 998,104</u>	<u>\$347,585,474</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 85,702,168	(2)
Loss adjustment expenses			14,399,334	(2)
Other expenses			520,395	
Taxes, licenses, and fees			2,647,353	
Federal and foreign income taxes			1,503,443	
Net deferred tax liability			28,574,700	
Unearned premiums			5,911,332	(3)
Dividends declared and unpaid: policyholders			15,531	
Ceded reinsurance premiums payable			574,747	
Remittances and items not allocated			13,839	
Provision for reinsurance			133,000	
Payable to parent, subsidiaries and affiliates			<u>4,562,258</u>	
Total liabilities			144,558,100	
Common capital stock		\$ 5,200,000		
Gross paid-in and contributed surplus		3,255,000		
Unassigned funds		<u>194,572,374</u>		
Surplus as regards policyholders			<u>203,027,374</u>	
Total liabilities, surplus and other funds			<u>\$347,585,474</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2004

Statement of Income

Underwriting Income

Premiums earned		\$ 40,626,140
Deductions:		
Losses incurred	\$24,931,984	
Loss expenses incurred	5,850,450	
Other underwriting expenses incurred	<u>10,652,806</u>	
Total underwriting deductions		<u>41,435,240</u>
Net underwriting loss		(809,100)

Investment Income

Net investment income earned	\$ 4,302,498	
Net realized capital gains	<u>64,503</u>	
Net investment gain		4,367,001

Other Income

Net gain from agents' or premium balances charged off	\$ 45,691	
Aggregate write-ins for miscellaneous income	<u>(3,824)</u>	
Total other income		<u>41,867</u>
Net income before federal income taxes		3,599,768
Federal income taxes incurred		<u>1,650,774</u>
Net income		<u>\$ 1,948,994</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2003		\$184,645,752
Net income	\$ 1,948,994	
Change in net unrealized capital gains	(19,596,063)	
Change in net deferred income tax	35,212,571	
Change in nonadmitted assets	662,120	
Change in provision for reinsurance	<u>154,000</u>	
Change in surplus as regards policyholders for the year		<u>18,381,622</u>
Surplus as regards policyholders, December 31, 2004		<u>\$203,027,374</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2001 through December 31, 2004

Surplus as regards policyholders, December 31, 2001, per Examination			\$142,012,540
	<u>Gain in</u> <u>Surplus</u>	<u>Loss in</u> <u>Surplus</u>	
Net income	\$15,847,877	\$	
Net unrealized capital gains	16,326,596		
Change in deferred income tax	28,961,853		
Change in nonadmitted assets		274,492	
Change in provision for reinsurance	<u>153,000</u>	<u></u>	
Totals	<u>\$61,289,326</u>	<u>\$ 274,492</u>	
Net increase in surplus as regards policyholders			<u>61,014,834</u>
Surplus as regards policyholders, December 31, 2004, per Examination			<u>\$203,027,374</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Cash and Short-term Investments

The Company does not have formal written procedures for identifying long outstanding unpaid cash items and escheating such items to the State in accordance with the various Unclaimed Property Laws. It is recommended that the Company adopt formal written procedures to identify and report such items in accordance with the unclaimed property laws of applicable states.

(2) Losses and Loss Adjustment Expenses

The California Department of Insurance (CDI), pursuant to California Insurance Code Section 733(g), retained an independent actuary for the purpose of providing a full actuarial evaluation of the Company's loss and loss adjustment expense reserves as of December 31, 2004. Based on the evaluation and the review of the work by a Casualty Actuary from the CDI, the Company's December 31, 2004 reserves for losses and loss adjustment expenses were determined to be reasonably stated and have been accepted for purposes of this examination.

(3) Unearned Premiums

The Company is not in compliance with Statement of Statutory Accounting Principles (SSAP) 53 because it records premium as earned when installments are billed, resulting in an overstatement of premium earned. Only the deposit portion of premium is earned on a daily pro-rata basis. While the overstatement of premium earned was not deemed material, it is recommended the Company comply with SSAP 53 by setting up a liability for unearned premium that accurately reflects the amount of premium related to the unexpired portion of the policy. This was also noted in the prior examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Information Systems Control Environment (Page 6): It is recommended that the Company work with its data processing vendor, Remote Data Solutions, to resolve the deficiencies identified during the information systems review.

Comments on Financial Statement Items – Cash and Short-term Investments (Page 11): It is recommended that the Company adopt formal written procedures in accordance with the unclaimed property laws of applicable states.

Comments on Financial Statement Items – Unearned Premiums (Page 11): It is recommended the Company comply with SSAP 53 by setting up a liability for unearned premium that accurately reflects the amount of premium related to the unexpired portion of the policy.

Prior Report of Examination

Accounts and Records–Information Systems Review (Page 8): It was recommended the Company continue to work with its data processing vendor, Remote Data Solutions, to resolve the deficiencies identified during the Information Systems Review. The Company has partially implemented the recommendations made in the prior examination report.

Comments of Financial Statement Items – Loss Adjustment Expenses (Page 13): It was recommended the Company classify Adjusting and Other expenses in accordance with the NAIC Annual Statement Instructions as opposed to just allocating a portion of the total. It was also recommended the Company develop a claims manual to comply with CCR, Title 10, Section 2695 (2) (A). The Company is now in compliance.

Comments on Financial Statement Items – Unearned Premiums (Page 13): It was recommended the Company comply with SSAP 53 by setting up a liability for unearned premium that

accurately reflects the amount of premium related to the unexpired portion of the policy. The Company has not complied with this recommendation.

ACKNOWLEDGEMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

Kyo Chu, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California